



A Law Firm in the People Business

Current Status of the Legislation

The House previously passed the minimum wage increase without these Section 409A and Section 162(m) changes. So, now, the House and Senate versions of the minimum wage bill must be reconciled and reapproved by both houses. It is not certain that the reconciled bill will contain these changes, but the margin by which they passed the Senate suggests that they have significant support in Congress. The final bill will also need to be signed by President Bush before it becomes law.

We will continue to monitor this legislation and let you know about additional developments, but please feel free to contact Toby Walls at 404.888.8870 if you have any questions about it in the meantime.



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The Senate Passes a \$1 Million Cap on Deferred Compensation and Changes to Executive Compensation Deduction Rules

On February 1, by an overwhelming 94-3 margin, the Senate passed a bill increasing the minimum wage. In addition to increasing the minimum wage, this bill also included an annual limit on nonqualified deferred compensation and modifications to the rules for deducting certain executive compensation.

Cap on Deferred Compensation. The Senate bill imposes an annual cap on the amount that an individual can defer under nonqualified deferred compensation plans. The amount of this cap is equal to the lesser of (i) the average annual compensation paid to the executive during the 5 previous years, or (ii) \$1 million. This cap applies to all amounts that constitute deferred compensation under Section 409A of the Internal Revenue Code, so it has a very broad application. In addition to traditional contributions to deferred compensation plans, the value of SERPs, certain severance arrangements and some types of equity-based compensation are subject to this limit as well. Though the text of the bill itself is not entirely clear on this point, the Report of the Senate Finance Committee indicates that earnings credited with respect to previously deferred amounts are also subject to this cap.

If this cap is exceeded, the individual will be subject to punitive tax treatment under Section 409A. This means that all amounts deferred by the executive under all similar arrangements that are subject to 409A will be subject to immediate taxation and a 20% penalty tax.

The bill provides that this cap will be effective beginning January 1, 2007, and will apply to earnings on any amounts deferred on or after that date. However, the IRS is directed to create a transition rule under which deferrals may be cancelled during 2007 to avoid this cap.

Deduction Changes. Section 162(m) of the Internal Revenue Code imposes a \$1 million limit on the deduction that a publicly traded company may claim for certain compensation paid to its CEO and 4 highest paid officers.

Under existing law, SEC proxy reporting rules are used to identify the executives subject to the \$1 million limit. Currently, an executive must be the CEO or one of the 4 highest paid officers on the last day of the year to be subject to this limitation. However, the Senate bill provides that an individual who is the CEO during any part of the year or is one of the 4 highest paid officers for the year will be subject to Section 162(m). In addition, any individual who is covered by Section 162(m) during 2007 or any later year will be subject to the deduction limitation in all future years.

Another consequence of "delinking" the determination of CEOs and officers covered by Section 162(m) from the SEC's reporting requirements is that certain officers of U.S. subsidiaries of companies traded on foreign stock exchanges may become subject to the deduction limit. Currently, these officers are not covered by Section 162(m) if the foreign parent is not subject to the SEC proxy rules.

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